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Ratings

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Research Update:

AES Panama 'BB-' Rating Affirmed As Operating And Financial Performance Is In Line With Expectations; Outlook Stable

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Overview

- AES Panama's operating and financial performance was in line with our expectation, as seen in its adjusted EBITDA of approximately $115 million in 2015 and $30 million in the first quarter of 2016. We expect main credit metrics will remain stable and consistent with our aggressive financial risk profile in the next couple of years, with a projected debt to EBITDA in the 4.0x area and funds from operations (FFO) to debt of about 15%.
- We're affirming our 'BB-' ratings on Panama-based power generator and on its senior unsecured bonds.
- The outlook remains stable and primarily reflects our expectation of a moderately high likelihood of extraordinary support from the Panamanian government. It also reflects our belief that hydrology conditions in the country would be normal in 2016 and 2017 and the company will maintain a more conservative commercial strategy, which would allow to maintain leverage in the projected range.

Rating Action

On July 7, 2016, S&P Global Ratings affirmed its 'BB-' corporate credit and issue-level ratings on AES Panama S.R.L. The outlook remains stable.

Rationale

The affirmation reflects our expectation that the company's cash flow generation will continue to improve in 2016 and afterwards. This would allow its financial metrics to remain in line with our aggressive financial risk profile, as seen in projected debt to EBITDA and FFO to debt of in the area of 4.0x and 15%, respectively, in the next two years. The recovery in the company's metrics was mainly due to more favorable hydrology conditions and a likely lower exposure to the high spot prices. AES Panama adopted a more conservative commercial strategy after the drought in 2013 and 2014 impaired the company's financial performance. Since then, the company has lowered the level of contracted energy, working with a 5%-10% cushion for its firm capacity to mitigate hydrology fluctuations, and added 72 megawatts (MW) through a diesel-powered barge to its total capacity to diversify its energy resources.

The ratings continue to incorporate our view that there is a moderately high likelihood that the government of Panama would provide timely and sufficient extraordinary support to the company in the event of financial distress. In accordance with our criteria for government-related entities, our view is based on our assessment of AES Panama's role as the largest producer of energy and the low-cost power generator in Panama and its strong link to the government, which has a majority stake (50.5%) in the company. The AES Corp. (BB/Stable/--) holds 49% and AES Panama's employees hold the remaining 0.5%.

We continue to view AES Panama's business risk profile as fair, reflecting the large-scale operations. Combined with AES Changuinola, the company has an aggregate installed capacity of 777 MW, representing 26% of the country's overall energy installed capacity. We also view positively the company's stable revenue, owing to the three- to four-year power purchase agreements (PPAs) with large-scale creditworthy clients and the major distribution companies in the country, the operating efficiency, as seen in more than 85% of availability factors in the past five years, and the low-cost energy production at hydro-based plants, which generate 85% of firm capacity. The mitigating factor is volatile profitability, due to vulnerability to the hydrology risk.

As a result of the extreme drought in 2013 and 2014, AES Panama's net generation was 1,972 gigawatt hours (GWh) in 2014 and the company had to buy the balance of around 2,500 GWh in the spot market, which was trading at high prices averaging $217 per megawatt hour (MWh). This undermined the company's leverage metrics, including FFO to debt of -1.3% and debt to EBITDA of 18.3x in 2014. As a result of more favorable hydrology in 2015, which reduced spot-market purchases at prices of an average $90 per MWh, AES Panama's adjusted EBITDA rose to $115 million. Therefore, its FFO to debt improved to 15.5%, debt to EBITDA to 4.3x, FFO cash interest coverage to 4.3x.

Our base-case scenario assumes the following factors:

- A slight contraction in revenue, based on lower level of contracted energy, with stable contracted capacity of 90%-95% in the next two years.
- Average contracted prices of $96 per MWh in 2016 and $100 per MWh in 2017.
- Average spot prices of around $70 per MWh in 2016, slightly above current market prices in Panama, and $90 per MWh afterwards, based on our view of normal hydrology conditions and average oil prices of $45 per oil barrel (bbl) in 2017 and $50 per bbl starting in 2018, according to our oil price deck (see "S&P Lowers Its Hydrocarbon Price Deck Assumptions on Market Oversupply; Recovery Price Deck Assumptions Also Lowered," published Jan. 12, 2016).
- Hydrology in line with historical average.

Based on these assumptions, we arrive at the following credit metrics for 2016 and 2017 respectively:

- FFO to debt of 16% and 17%;
- Adjusted debt to EBITDA of 3.6x and 3.5x; and
- FFO to cash interest coverage of 4.7 and 5.1x.

We adjust our debt figures to include the present value of the future stream of capacity payments under AES Panama's and AES Changuinola's PPAs. We view long-term PPAs as creating fixed, debt-like financial obligations that substitute for debt-financed capital investments in generation capacity. The adjustment pushes up debt to $134 million.

AES Panama owns and operates four hydroelectric plants totaling 482 MW of installed capacity and a diesel-powered barge with 72 MW of installed capacity. In addition, AES Panama has a PPA with hydropower generator, AES Changuinola, from which it buys 175 MW or 100% of the generator's firm capacity until 2030 at a fixed price. The AES Corp. holds a majority stake in AES Changuinola that has 223 MW of installed capacity.

Liquidity

We continue to view AES Panama's liquidity as less than adequate. In our view, the company's liquidity sources will just be sufficient to cover its uses for the next 12 months, without a 20% cushion to absorb adverse effects, such as hydrology risk. We also believe that the company has good access to banks and the capital markets, as seen in its $300 million 2022 bonds issuance. In addition, we believe that the company has adopted a prudent risk management strategy after 2014, and would have flexibility to reduce dividend payments in case of liquidity constraints. The company doesn't have financial covenants in its existing debt that could cause the debt payment acceleration or event of default.

Principal liquidity sources:

- Cash and short-term investments for $28 million as of March 31, 2016;
- FFO generation of about $75 million; and
- Undrawn committed bank lines of $5 million.

Principal liquidity uses:

- $83 million bond maturity in December 2016;
- Working-capital requirements for about $5 million;
- Capital expenditures (capex) for about $11 million, excluding any extraordinary maintenance at the thermal plant; and
- Flexibility to forego dividend payments.

Outlook

The stable outlook on AES Panama primarily reflects our expectation of a moderately high likelihood of extraordinary support from the Panamanian government. In addition, it reflects our expectation that AES Panama's adjusted FFO to debt and adjusted debt to EBITDA to remain in the range of 15%-20% and 4.0x, respectively, in the next 12 months, thanks to the consolidation of its hydrology management risk strategy amid normal hydrology conditions.

Downside scenario

Because AES Panama is a government-related entity, a downgrade is possible if we were to revise its stand-alone credit profile (SACP) downward to 'b-' in the next 12 months. That could occur, for example, if the company is unable to implement its hydrology risk management plan due to worse-than-expected hydrology conditions or embarks on a more aggressive commercial strategy, resulting in FFO to debt below 12% and/or a liquidity assessment revision to a weaker category. A downgrade of Panama's local currency rating to 'BB', while all other factors remain unchanged, could also trigger a downgrade of the company.

Upside scenario

We could revise the outlook to positive if AES Panama extends the maturity of its 2016 bonds beyond 2017 and cushions its liquidity, which should help amid worse-than-expected hydro conditions. Under those conditions, we would revise our liquidity assessment on the company to adequate. The latter, along with the consolidation of the conservative hydrology risk management plan, which would stabilize cash flows and keep FFO to debt consistently above 12% and debt to EBITDA below 5.0x, would trigger an upgrade.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Stable/--

Business risk: Fair
- Country risk: Moderately High risk
- Industry risk: Moderately High risk
- Competitive position: Fair

Financial risk: Aggressive
- Cash flow/leverage: Aggressive

Anchor: bb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Less than Adequate (-1 notch)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: b+

Related government rating: BBB
Likelihood of government support: Moderately high (+1 notch)

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Stand-Alone Credit Profiles: One Component of a Rating, Oct. 1, 2010
- 2008 Corporate Criteria: Rating Each Issue, April, 15, 2008

Ratings List

Ratings Affirmed

AES Panama S.R.L.	
Corporate Credit Rating	BB-/Stable/--
Senior Unsecured	BB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings public website at www.standardandpoors.com. Use the Ratings search box located in the left column.